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ISSUES PAPER: REVIEW OF INSURANCE (PRUDENTIAL SUPERVISION) ACT 2010 CAPTIVE INSURANCE COMPANIES

Introduction

This submission is in support of the New Zealand Captive Insurance Association's submission to the Reserve Bank on the Issues Paper outlining scope of the review of the Insurance (Prudential Supervision) Act 2010. Our submission is from the perspective of an organisation who has an established captive insurance subsidiary company, Unison Insurance Limited (UIL).

Background

Unison Networks Limited (Unison) and its subsidiaries (together the Group) provide electricity distribution and line function services to around 110,600 customers, as well as fibre optic network interconnections and related services throughout the Hawke's Bay, Taupo and Rotorua regions. The Unison Group is wholly owned by the Hawke's Bay Power Consumers' Trust on behalf of Hawke's Bay electricity consumers. There is currently a very limited insurance retail market place for what are known as "T & D assets" (transmission and distribution equipment including poles, pole-mounted assets, wires, and underground cables). To address this gap, in 2009, Unison established UIL, as Unison's captive insurer, in order to provide cost effective cover for Unison's uninsured risk.

Unison, as a 'Lifeline Utility', has an obligation under the Civil Defence and Emergency Management Act 2002, amongst other matters, to ensure we are able to function to the fullest extent possible, during and after an emergency. The establishment of UIL, is a measure undertaken by Unison to assist the meeting of this obligation by providing a fund to spread the costs of a catastrophic event over time, rather than recover costs from consumers at the time of the event. UIL provides a vehicle to better manage Unison Group's risk compared to similar entities where T & D assets remain uninsured.

Response to Issues Paper

From our perspective the Reserve Bank's regulation of the UIL as a Captive Insurer imposes significant compliance costs with no discernible benefit to UIL, its parent (Unison), stakeholders in the general insurance industry or the general public. And that these compliance costs are

disproportionate for a captive which was established to manage a risk which was initially uninsurable in the general insurance market.

In particular, we believe the following compliance requirements significantly increase compliance costs:

- Requirement to comply with the Financial Market Conduct Act.
- Requirement to be an Issuer.
- Requirement to complete a semi-annual filing.

The requirement to comply with the Financial Market Conduct Act and to be an Issuer has significant time and cost to the preparation and audit of the annual and semi-annual financial statements. Additionally, the requirement to complete a semi-annual filing again significantly increases compliance costs without providing any benefit to the captive, its parent, stakeholders in the general insurance industry or general public. By virtue of UIL being a captive, there is a tight relationship between UIL and Unison, its the parent company. Such that both parties have exactly the same understanding of the nature of risk faced by Unison. Unison has a full and complete understanding of the financial position of its captive, including its ability to meet claims.

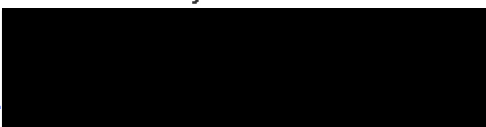
The position of a captive insurance company and its parent is completely different to a person or entity procuring external insurance. There is not the asymmetry of information which justifies prudential supervision of general, third party insurers which warrants the Reserve Bank's prudential supervision and monitoring.

We strongly believe that the obligations placed on captives do not enhance the management of the captive, or the parent company's understanding of the captive. The result is significant compliance costs imposed on a captive with no added benefits. The result is that expenditure on compliance obligations detracts from the build-up of capital in UIL and therefore reduces the extent of insurance cover available.

Accordingly, we strongly question the extent of regulation of captive insurers and would request that Reserve Bank carries out, and justifies, on a cost benefit basis regulation applied to captive insurers. Fundamentally, the Reserve Bank needs to establish what market failure or asymmetry of information exists between a Captive and its Parent that would be resolved by regulation, in light of the transparency of information between Captives and their Parents.

We would be happy to discuss the arrangements we have in place at Unison and UIL if that would assist the Reserve Bank's understanding.

Yours sincerely



Nathan Strong
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